

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

December 23, 1997

ORDER ESTABLISHING METHOD
FOR SETTING RATES IN
ANNUAL AFOR FILINGS

PUBLIC UTILITIES COMMISSION
Investigation Into Regulatory
Alternatives for the New England
Telephone and Telegraph Company
d/b/a NYNEX

Docket No. 94-123

PUBLIC UTILITIES COMMISSION
Proposed Modification and
Exemption to Alternative Form
of Regulation (AFOR) for
New England Telephone and
Telegraph Company d/b/a NYNEX

Docket No. 97-079

WELCH, Chairman; HUNT and NUGENT, Commissioners

I. SUMMARY OF DECISION

This Order clarifies the method by which Bell Atlantic will calculate the revised price regulation index (PRI), actual price index (API), and the maximum level of rates allowed in its annual rate revision filings under the alternative form of regulation (AFOR) ordered at Docket No. 94-123.

II. BACKGROUND

In Docket No. 94-123, we implemented of an alternative form of regulation (AFOR) for New England Telephone and Telegraph Company d/b/a NYNEX (now Bell Atlantic-Maine). In that Order, we established procedures for annual rate revisions. Bell Atlantic must file a proposed rate revision on September 1 of each year and the Commission normally approves those rate changes for effect on December 1 of each year.

During the course of NYNEX's first annual AFOR filing, in Docket No. 96-440, it became apparent that certain matters had not been addressed by the AFOR Order or were unclear. In the Notice issued in Docket No. 97-079 we proposed a methodology that we understood had been agreed to by the Company and members of the Commission's Staff.¹ The Company filed comments indicating

¹The Notice in Docket No. 97-079 also addressed one other issue, whether to provide a credit for migration from two toll services to another toll service. That issue was decided in an Order issued in this docket on November 25, 1997.

that it did not agree, at least in some respects, with the methodology described in the Notice. Subsequently, the Company and Commission Staff conferred further and, on September 23, 1997, filed a letter that stated they had agreed on a methodology and that described the methodology.

III. DECISION

In this Order, we approve a methodology that is consistent with the September 23 letter (attached). This Order effectively amends the AFOR Order issued in Docket No. 94-123; we exercise our authority under 35-A M.R.S.A. § 1321 to amend that Order.

By this Order, we confirm the method stated in the AFOR Order for annual recalculations of the price regulation index (PRI). We also establish the Actual Price Index (API)² and clarify the method for calculating the maximum overall rate level for core rates that Bell Atlantic is permitted to implement in the annual AFOR filing.

A. The Indices

1. The PRI

The PRI (or price regulation index) establishes the maximum overall level of rates that Bell Atlantic may establish for core services. The PRI is recalculated each year, based on two variable factors (inflation and exogenous cost changes) and a fixed productivity factor. The formula is shown below. The PRI shall be calculated to two decimal places.

The PRI is a "rolling" index that shows the cumulative change since the beginning of the AFOR, when it was set at 100. Thus, if the change in the PRI at the end of the first year was -2%, the PRI for the second year would be 98. If the change in the PRI at the end of the second year was also -2%, the PRI at the beginning of the third year would be 96.04.

After the first annual change in the PRI, it is not possible to determine the annual change in the PRI from the PRI itself. In order to determine the most recent annual change, it is necessary to divide the current PRI by the previous PRI.

²The API is not described in the AFOR Order (Docket No. 94-123), but Bell Atlantic provided an API calculation in its first annual AFOR filing in Docket No. 96-440.

2. The API

The Actual Price Index (API) is an index that runs in parallel to and is comparable to the PRI. The API, like the PRI, is a "rolling," cumulative index that shows the change in the actual overall price level since the beginning of the AFOR. A comparison between the current PRI and the current API shows the relationship between the maximum overall price level allowed and the actual overall price level. The API is derived from a revenue calculation, i.e., the aggregate of all of Bell Atlantic's rates, weighted by the billing units for each rate element.³ The API shall be calculated to two decimal places.

The API is necessary to implement the "banking" provision at page 61 of the AFOR Order. If, at the beginning of an AFOR rate year, the API is below the PRI, Bell Atlantic may "bank" the difference. At the beginning of the following AFOR rate year, Bell Atlantic does not have to reduce its aggregate prices by the amount of the change in the PRI; rather, it must reduce its prices only by the amount that is necessary to make sure that the API is no greater than the PRI.

B. Annual Calculation

The AFOR Order requires Bell Atlantic to file the revised PRI and proposed new rates on September 1 of each year. Rates approved in that filing are in effect for 12 months from the following December 1 to November 30 of the next year. The calculational steps described below include several "revenue" calculations.

The AFOR regulates Bell Atlantic's rates, not its revenues.⁴ However, whether its overall level of rates is within the amount allowed by the PRI is determined most simply by these revenue calculations, which consist of each rate multiplied by its respective units sold, all added together. The revenue calculations are used only for measurement purposes and do not represent an actual level of revenue at any point in time.⁵

³Any given service may have more than one rate element. For example, if a service has a flat monthly fee and a per-minute usage rate, there will be two rate elements.

⁴For example, the methodology described herein ensures that if Bell Atlantic achieves a growth in sales during a period when rates are fixed, it retains that revenue growth.

⁵An alternative method that Bell Atlantic has used would divide the various revenue calculation of Step 2 below by total billing units for all rates, thereby producing an "average rate"

The calculational steps described below determine whether Bell Atlantic's proposed revised rates are lawful under the AFOR:

Step 1: calculate the revised PRI, using the following formula (also stated at page 38 of the AFOR Order):

$$\text{PRI (new)} = \text{PRI (current)} \times [1 + (\text{GDP-PI} - X \pm Z)/100]$$

Where:

GDP-PI = Percent change in the Gross Domestic Product Price Index for the first quarter (ending March 31) of the current year compared to the same quarter in the previous year.⁶

X = Productivity offset of 4.5%.

Z = Exogenous changes, expressed as a percentage of the revenue calculation of Step 2.

Step 2: calculate revenues for the current AFOR rate year.⁷ Multiply the rate for each rate element that was in effect at the beginning of the year by the current AFOR year's billing units for each rate element.⁸ Add those separate revenue calculations for the total

for all services. Except for its use as a calculational tool, the average rate for all services is not a meaningful number, and we find that this additional step is not necessary.

⁶The AFOR Order requires the use of the GDP-PI for the second quarter. An Order issued on August 23, 1996 in Docket Nos. 94-123 (the AFOR case) and 96-440 (the first annual AFOR filing) changes the measuring period to the first quarter of each year.

⁷The "current" AFOR rate year is the year in effect at the time of the September 1 filing and that ends on November 30. The "new" AFOR year begins on December 1 and is the year for which Bell Atlantic will propose revised rates. For the purpose of the revenue calculation, however, Bell Atlantic will use billing units for the period described in footnote 8.

⁸The letter states that Bell Atlantic will use the "billing determinates for the 12-month period ending June 30 [of the current AFOR rate year], or a representative sample that is annualized, if full-year results are unavailable." For the first two annual AFOR filings, Bell Atlantic has used the billing units for March of the current year annualized by "closing factors." The letter is consistent with the AFOR Order at 105-106, which requires Bell Atlantic in each annual AFOR filing to "file"

revenue calculation. Price changes that took place during the year are ignored.

Step 3: determine the maximum amount of revenue allowed. Divide the current year's revenue (from Step 2) by the API in effect at the beginning of the current AFOR rate year; multiply that result by the new PRI (from Step 1).

Step 4: calculate the revenue that would be produced by the proposed rates.⁹ Multiply the proposed rate for each rate element by the current year's billing units for that rate element (the same billing units used in Step 2). Add those amounts for a total revenue amount for the new AFOR year.¹⁰

Step 5: determine whether the proposed rates are at or below the maximum allowed level. The revenue amount calculated in Step 4 must be less than or equal to the maximum allowed revenue calculation of Step 3. If it is not, Bell Atlantic must revise its proposed rates and Step 4 must be recalculated.

Step 6: recalculate the API for the new AFOR year.

Divide the revenue calculation for the new AFOR year (Step 4) by the revenue calculation for the current AFOR year (Step 2); multiply that ratio by the API for the current year.¹¹

billing determinants for "the previous 12-month period ending June 30."

⁹Proposed rate changes must, of course, comply with the pricing rules stated at pp. 56-68 of the AFOR Order.

¹⁰"Proposed rates" include all rates that Bell Atlantic proposes will be in effect for the following year, including those presently in effect and including any that were changed during the current year.

¹¹The method described for Step 6 is algebraically identical to the method described in the attachment to the letter filed by Staff ($API\ (new) = API\ (current) \times (1 + API\ adjustment)$) in which the "API adjustment" is the percentage change in prices or revenues.

Accordingly, we

O R D E R

In each annual AFOR filing, Bell Atlantic shall recalculate the revised Price Regulation Index (PRI), the maximum overall level of revised rates for core services and the revised Actual Price Index (API) for core services as stated in this Order.

Dated at Augusta, Maine this 23rd day of December, 1997.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Hunt